

SUBJECT: Accelerating escheat of abandoned proceeds from demutualization

COMMITTEE: Government Reform — favorable, without amendment

VOTE: 4 ayes — Swinford, Callegari, Casteel, R. Cook

0 nays

3 absent — Gallego, Allen, T. Smith

WITNESSES: For — Jay Thompson, Prudential Insurance Company

Against — None

On — Susan Biles, Comptroller's Office

BACKGROUND: Property Code, sec. 72.101 sets forth state law regarding abandoned property. Personal property is presumed to be abandoned if, for more than three years, the existence and location of the owner is unknown to the property holder and no claim or act of ownership has been exercised. Abandonment of stock or intangible ownership interest in a business association begins on the first date that either a sum payable as a result of the ownership interest is unclaimed by the owner, or a communication to the owner is returned undeliverable by the U.S. mail.

Property Code, sec. 74.301 requires entities holding abandoned property to deliver it to the state comptroller by November 1 of each year. Reversion of abandoned property to the state, called escheat, occurs when a person dies without a legal will and without any legally recognizable heirs, or when a bank account is left inactive for an extended period. If the abandoned property is stock or some other intangible ownership interest, a property holder must deliver a duplicate certificate or other evidence of ownership to the state. The comptroller acts as custodian for unclaimed property until the owners or heirs are located. Cash is held in general revenue until claimed; personal property is auctioned periodically, with the proceeds held in general revenue.

A mutual insurance company is a corporation with no shareholders. Mutual companies return surplus value or profits to their policyholders through refunds or lowered rates. Policyholders have an intangible interest, represented by their voting rights in the company, to mutual company surpluses. The policyholders, as members of the corporation, have the right to vote at annual meetings and to receive any remaining surplus value if the corporation is liquidated or demutualized.

Demutualization is a process by which a mutual life insurance company reorganizes its corporate structure to become a stock company, a corporation with shareholders who may or may not be policyholders. Each shareholder's ownership interest is represented by shares of stock, which usually can be sold. Demutualization gives policyholders two potential interests in the company: the cash value of their intangible interest in any company surplus, and shares in the company's capital stock.

DIGEST:

HB 64 would specify that property distributable under a demutualization is presumed abandoned on the first anniversary of the demutualization if the property owner could not be reached by U.S. mail and had not communicated with the property holder or the holder's agent about his or her interest in the property. Abandoned proceeds from a demutualization or related insurance company reorganization would have to be delivered to the comptroller on or before the following August 1.

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect November 1, 2003.

**SUPPORTERS
SAY:**

Accelerating the dormancy period for abandoned proceeds would speed the escheat on demutualization, adding to state general revenue in the coming biennium. During fiscal 2002, the comptroller received \$165.5 million in unclaimed property revenue, of which more than \$60.5 million was returned to the rightful owners. Only about 30 to 35 percent of money received as unclaimed property is claimed; the other 65 to 70 percent remains in general revenue and can be used to pay for state operations until claimed. According to the comptroller, under the current dormancy period, about \$10 million in abandoned demutualized funds would not be reportable until fiscal 2006-07. HB 64 would make those funds reportable to the state during fiscal 2004-05,

potentially making available an estimated \$6.5 million in additional funds to general revenue. While the state can use these funds, it holds them in perpetuity for the rightful owners or their heirs, so policyholders never lose their legal interest in their property.

Mutual insurance companies take their fiduciary responsibilities seriously and would not use this legislation to harm consumers or to pass responsibility to the state. The only economic incentive for a mutual company to demutualize is to attract more capital in order to expand business surplus, not to avoid compensating policyholders for their ownership interests in company surplus. With the new regulatory environment for rates, financial monitoring requirements, and other state and federal rules, it is highly unlikely that a financially troubled insurance company would demutualize without strict state and federal oversight that ultimately would protect the rights of consumers.

**OPPONENTS
SAY:**

While it might make more revenue available for the state, HB 64 would not benefit consumers. In fact, it could leave some policyholders and their heirs, especially those who have left Texas, without an easy way of recovering their lost assets. Policyholders are better off having their assets held for three years with the insurance company, which is more likely to have their last known addresses and the names of surviving heirs than is the state. For solvency reasons alone, active policyholders benefit from keeping abandoned proceeds with the insurance company longer because they create more surplus, helping insurers maintain a greater margin of error for paying out future claims.

**OTHER
OPPONENTS
SAY:**

HB 64 could encourage more insurance firms to convert to stock companies, a trend that might not be in the best interest of policyholders. While it might benefit insurers' bottom lines to demutualize, accelerate losses, and transfer responsibility to the state for finding and paying policyholders for surplus value, consumers might not benefit. Because stock companies must satisfy the demands of outside investors rather than the demands of policyholders, profit motives inherent in the demutualization process could create potential conflicts of interest between shareholders and policyholders.